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Prospects for US-Egyptian Relations

Special National Intelligence Estimate

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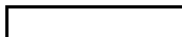
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PROSPECTS FOR US-EGYPTIAN RELATIONS

Information available as of 21 October 1982 was
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THE NATIONAL FOREIGN INTELLIGENCE BOARD CONCURS.

The following intelligence organizations participated in the preparation of the Estimate:

The Central Intelligence Agency, the Defense Intelligence Agency, the National Security Agency, and the intelligence organizations of the Departments of State and the Treasury.

Also Participating:

The Assistant Chief of Staff for Intelligence, Department of the Army

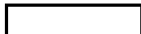
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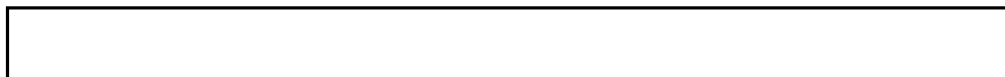
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SCOPE NOTE

This Special National Intelligence Estimate examines the prospects for the US-Egyptian special relationship over the next year. It deals with Egypt's domestic problems primarily as they affect that relationship.



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CONTENTS

	<i>Page</i>
SCOPE NOTE	iii
KEY JUDGMENTS	1
DISCUSSION	3
Lebanon's Impact	3
Domestic Perceptions	4
[REDACTED]	5
Shared Strategic-Military Goals	7
Economic Linkages and Problems	8
Outlook	9
ANNEX A: Biographic Portraits	A-1
ANNEX B: Economic Prospects	B-1

v

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KEY JUDGMENTS

The US-Egyptian relationship is maturing from its early political "honeymoon" to a more complex, yet still mutually beneficial, connection. The Israeli invasion of Lebanon led to serious strains in US-Egyptian ties and brought to the surface deeper problems that beset the relationship. Most Egyptians, including President Mubarak and key military leaders, feel the United States has failed to restrain Israel in the region or press Tel Aviv to make concessions that Egypt believes are essential to resolving the Palestinian issue. Cairo also believes Washington has not paid appropriate attention to Egyptian concerns in the peace process.

US policy toward the Arab-Israeli dispute will continue to be one of the most important factors influencing US-Egyptian ties. Arab-Israeli issues will remain the most volatile source of strain. President Reagan's peace initiative has significantly improved the tone of the relationship, but Egyptians are deeply skeptical that the United States has the determination to pursue its initiative in the face of Israeli resistance.

The US economic and military assistance programs are vital to Egypt but have come under growing criticism in recent years. Unrealistic Egyptian expectations are partly to blame. Moreover, the Egyptians believe they have not yet received the parity in aid with Israel expected after Camp David. Such strains currently are manageable but could grow sharply if progress is not made in meeting Egypt's concerns. If Egypt perceives any detrimental changes in the aid relationship, it would have an immediate negative impact. In any case, as Egypt's tight foreign payments situation worsens next year, Cairo is likely to seek additional balance-of-payments support from the United States to help it delay economic reforms that might cause domestic instability.

Since the Israeli invasion of Lebanon, Egyptian leaders have publicly linked progress in the peace process to US-Egyptian strategic cooperation. Currently they are less willing than previously to allow Egyptian participation in highly visible combined maneuvers. They will continue to refuse to conclude a formal access agreement for US use of Egyptian military facilities.

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The enduring and stable elements of the US-Egyptian "special relationship" are mutual, shared objectives:

- A negotiated, comprehensive Arab-Israeli peace settlement.
- Opposition to Soviet and radical inroads in the Middle East.
- A politically stable and economically prosperous Egypt.

The volatility in the relationship is a product of different perceptions of how to achieve these objectives.

Mubarak's domestic political standing plays a key role in his readiness to cooperate with Washington. [REDACTED]

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[REDACTED] The Lebanon crisis and growing economic problems have undermined his credibility at home, and he is determined to avoid additional vulnerabilities that might stem from the US connection. While the Mubarak government has dealt firmly with Egypt's radical Islamic militants, it has not so far alleviated the underlying frustrations and despair on which radicalism and violence feed. The roots of these frustrations lie largely in the difficult economic and social conditions facing Egypt's urban population.

Unless the government demonstrates that it has the will and capacity to improve these conditions by convincing Egyptians that it has a well-thought-out, graduated program for economic improvement, threats to the regime will continue to grow. Should Mubarak's domestic problems worsen, he is likely to be more hesitant about open collaboration with the United States on political or strategic issues.

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DISCUSSION

Lebanon's Impact

1. The US-Egyptian special relationship that developed in the late 1970s and was highlighted by the US role in negotiating the Egyptian-Israeli peace treaty of March 1979 is undergoing a transformation. Although the connection is still strong, it is maturing into a more complex, yet still mutually beneficial, relationship.

2. The Israeli invasion of Lebanon generated the most serious policy differences between Egypt and the United States since 1979. The disagreement was highlighted by President Mubarak's refusal to support Ambassador Habib's efforts to evacuate the Palestine Liberation Organization from Beirut without linkage to renewed Middle East peace efforts. Egyptian officials, including the military, were deeply frustrated and angered by the invasion. Many Egyptians, like other Arabs, believe Washington approved of the Israeli action in advance and most were convinced it did not do enough to restrain Israel once the invasion began. The heavy civilian casualties during the siege of Beirut in August and the Israeli move into West Beirut in September deepened popular outrage and resentment toward the United States as well as Israel. Cairo's apparent inability to influence either Tel Aviv or Washington also frustrated the Egyptian leadership.

3. Despite the invasion, Mubarak did not renounce the peace treaty with Israel. Egyptian Government oil sales to Israel also were unaffected, and Egypt requested renewal of the discussions to settle the unresolved Tabah territorial dispute in the Sinai. Cairo, however, did freeze the normalization process—the building of closer political, economic, cultural, and military ties—with Israel, and Egypt's ambassador in Tel Aviv was recalled after the massacre in Beirut's Palestinian refugee camps.

4. The US-Israeli-Egyptian autonomy negotiations over the future of the West Bank and Gaza Strip have been affected as well. The negotiations had already been indefinitely suspended because Egypt refused to acquiesce in Israeli demands that talks take place in Jerusalem. Now Mubarak says Egypt will not return to

the negotiating table until Israel commits itself to a schedule for withdrawing its forces from Lebanon. In addition, Egypt says it wants Israel to redefine its position on Palestinian self-determination and the status of Jerusalem, halt the expansion and thickening of Jewish settlements, and make some confidence-building concessions before the talks resume. We believe it is unlikely that Egypt will return to the negotiating table without greater Arab participation.

5. Because of events in Lebanon, and Egyptian perceptions of the lack of strong US actions to restrain Israel, Mubarak undertook to put some distance between Egypt and the United States. Defense Minister Abu Ghazala (see annex A for biographic portraits) publicly linked progress on the Palestinian issue to future willingness to allow US use of military facilities in the region. Cairo [] indicated it wished to reduce the visibility of its military cooperation with the United States, and work on several joint projects was slowed temporarily. Egypt made clear its unwillingness to participate in the Jade Tiger combined US-Omani military exercise, belying its previous enthusiasm for playing a major role in US Rapid Deployment Force military operations in the Middle East. Cairo is willing to allow overflights and refueling, however, for the exercise.

6. Mubarak made clear that he wanted to avoid a serious rupture with Washington. The President told Egyptian journalists in early September to ease their criticism of the United States. He has consistently reiterated support for the Camp David process as well as his interest in continued US economic and military aid. Egypt has requested more military credits and increased flexibility in its use of US economic aid.

7. President Reagan's recent initiative concerning the West Bank and Gaza has significantly eased the strains in US-Egyptian ties. Egyptian officials have continued to emphasize the "positive aspects" of the initiative despite their displeasure over its ruling out of Palestinian statehood as a possible outcome and the

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lack of reference to the PLO. Cairo has also praised the results of the Arab summit in Fez, Morocco, as a step forward. Nonetheless, Ghazala has reiterated publicly the linkage between the peace process and strategic cooperation, and the Israeli move into Beirut after President-elect Bashir Jumayyil's assassination and the massacre that followed served to revive concern about the US ability to influence Tel Aviv. Egyptians are skeptical, moreover, that the United States has the determination to follow through with the initiative in the face of strong Israeli rejection.

Domestic Perceptions

8. We believe the extent of Egyptian suspicions about the US role in the Lebanese crisis reflects deeper doubts about some aspects of Egypt's close alliance with the United States. Disappointment with the US connection is intimately linked to disillusionment about the peace treaty with Israel. For many Egyptians, the peace negotiated in 1979 under US auspices has been a disappointment because:

- It has not brought prosperity as promised by the late President Sadat.
- It has cost Egypt the friendship and support of other Arab states.
- It has not brought the influence with Israel and the United States that Egypt expected.
- It has not yet spread and brought a peaceful solution to the overall Palestinian problem.

Inflated expectations are part of the problem. The Egyptian public had long been led to believe that peace would bring massive US aid and investment that would produce almost instant prosperity. Instead, economic conditions remain difficult. Moreover, Egyptians did not expect the treaty to result in a prolonged period of regional isolation.

9. Dissatisfaction with some of the results of the peace treaty does not translate into support for a return to belligerency, however, and few, if any, Egyptians favor another costly war with Israel. Instead, the Egyptian mood has become increasingly embittered toward the Begin government, especially since many believe Israeli actions like the Golan annexation, the raid on Iraq's nuclear facility, and the invasion of Lebanon were carried out in part to keep Egypt isolated from its Arab neighbors. Further,

Egyptians are sensitive to the charge that their unilateral settlement has made possible these Israeli actions. Bitterness with Israel has heightened interest in better ties with other Arabs. While Egyptians have always had mixed emotions about their Arab brothers, most increasingly favor a more active policy to seek rapprochement with the moderate Arab states.

10. Egyptians have long tended to overestimate the US ability to influence Tel Aviv. They believe Washington has failed to press Israel to make concessions they consider necessary for progress in the peace process. In addition, Egyptians feel the United States is taking Egypt for granted. They charge that Cairo has not been treated as a "full partner" and that its views on issues like Lebanon are not given sufficient weight. A critical factor governing future Egyptian attitudes will be not only the extent but the success of US efforts to convince Israel to accept President Reagan's peace proposals.

11. Frustrated by Israeli actions and perceived US inaction, Egyptians also have gradually voiced growing doubts about the economic and military benefits that the peace treaty brought. Many believe US economic aid and Sadat's "Open Door" economic policy failed to produce significant results. Moreover, many Egyptians are convinced that US economic assistance and policies that spur the private sector have fostered unprecedented corruption among the elite while doing little to help the average citizen. Moreover, many criticize US assistance for spending too much on feasibility studies, contract reports, and other bureaucratic items that do not directly benefit Egyptians. Some worry that US aid gives Washington too much influence on internal Egyptian economic decisions and would prefer a cash transfer disbursement—such as Israel receives—rather than specific project assistance.

12. US military aid has been criticized as well, especially the long delivery schedules and high costs. Egyptians want US military aid to equal that given Israel in quantity, quality, and terms. They have been unhappy settling for less, even though Egyptian technical shortcomings alone would limit the absorption of greater quantities of sophisticated equipment. Mubarak has been a tenacious advocate of high levels of security assistance and has argued frequently that any reduction in US aid would weaken his support in the military as well as Egyptian support for the US connection.

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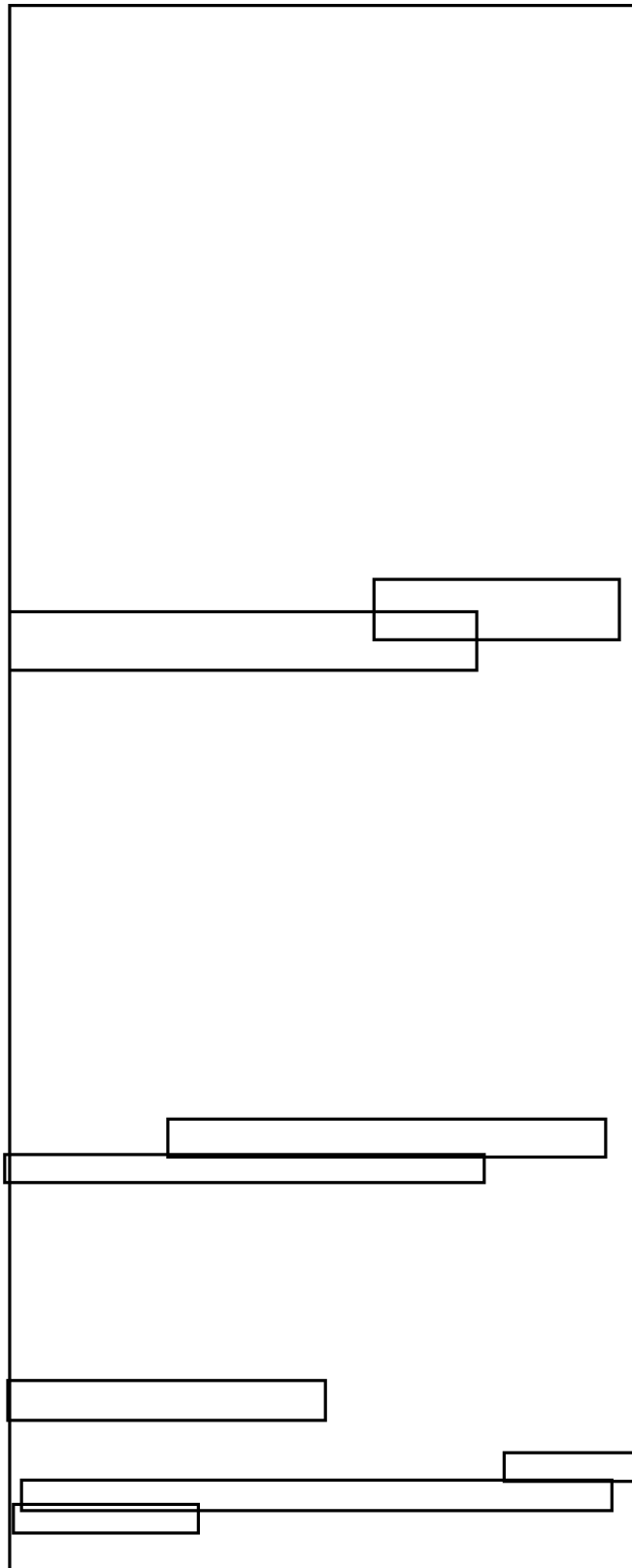
[REDACTED]

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13. Sadat's willingness to provide Egyptian military facilities to the United States, reiterated by Mubarak, has also aroused criticism and charges that the offer actually involved US bases. Opposition groups charged that the offer undermined Egypt's national sovereignty as well as its standing as a nonaligned nation. (See paragraphs 23 to 32 for additional information on military and economic linkages.)

14. The opposition has taken the lead in criticizing the US connection. Islamic fundamentalists, while welcoming Sadat's reversal of former President Nasir's close ties to the Soviets, have strongly criticized the peace treaty, US influence on Egypt's economy and society, strategic cooperation with Washington, and Egypt's estrangement from the other Arabs. The most important fundamentalist group, the Muslim Brotherhood, has been a particularly strong opponent of ties with Israel but has not advocated violence. While critical of Western cultural influence in Egypt, the Brotherhood is not as xenophobic as some other Islamic fundamentalist groups. More extreme groups, like the Jihad organization that was responsible for Sadat's assassination, are more likely to attempt anti-American and antiregime violence. The fundamentalists, especially the Brotherhood, enjoy widespread popular backing, and their hardline positions toward Israel have encouraged Mubarak to maintain a tough position vis-a-vis Israel. His refusal to visit Jerusalem last February reflected in part a desire to avoid fundamentalist ire.

15. The left, including some of Egypt's legal political parties, have been particularly critical of the United States. The National Progressive Unionist Grouping (NPUG) and the Socialist Labor Party echoed several leading fundamentalists in protesting the Israeli invasion and US policy in late June. Cooperation between the left and right is rare, but is a deep concern for the regime. Leftist leaders have called for a break in diplomatic ties with Israel, an embargo on oil sales to Israel, curtailment of US-Egyptian strategic cooperation, and improved Egyptian ties with the Arab states and the USSR. Some even urged a boycott of US trade. The NPUG has also criticized the new US peace initiative as insufficiently responsive to Arab interests. While few in numbers, the left has wide appeal among Egyptian intellectuals, giving it a fairly influential role. The tiny, illegal Communist Party is also critical of the United States but has little impact on Egyptian politics or popular opinion.



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[redacted]

lems. The soft oil market and the slowing of other key sources of foreign earnings will make it increasingly difficult to pursue rapid economic growth and expensive government consumer subsidy programs in the coming years. The public expects Mubarak to act decisively to improve economic conditions, but there is little public support for the far-reaching economic reforms needed to sustain a healthier economy in the coming years or even for the President's frank talk on what needs to be done to cope with the economy (see inset). The greatest threat to economic stability in the coming months is the possibility of a sharp decline in world oil prices. Egypt would have difficulty making up the loss in foreign earnings and would look to the United States for help.

[redacted] Most Egyptians still seem willing to give him more time to prove his abilities, and the military and internal security forces remain loyal. Mubarak has renewed the state of emergency to keep the Islamic extremists and other critics on the defensive. The Muslim Brotherhood, while still unsure of Mubarak, probably is not ready to challenge the regime. [redacted]

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Recent Remarks by President Mubarak on Egypt's Economy

- The main problem facing us is to try to ease the hardship of the people. We must devote tremendous efforts and pay maximum attention to this problem.
- France suffers from economic problems. Mexico is in debt. We are not the only ones who have problems. There is something we must do; stop talking, stop abusing each other and work instead. Nothing can do us any good but work.
- Do you know how much the subsidy for bread per year is? About 800 million [Egyptian] pounds. This is all the Suez Canal income plus 200 million. . . . The amount allocated for subsidizing corn, vegetable oil, and sugar is 408 million pounds. . . . The subsidies eat up the country's resources.
- The general policy of the country is not to touch the subsidies, not to increase the prices of necessary products for the toiling factions.
- [We cannot] press a button on a magic wand to get watermelons. No, this is not the case. We should all know the reality and the facts. . . . We must all work.

21. Over the longer run, Mubarak's staying power will depend on his ability to convince Egyptians of his leadership skills and his success at making progress on pressing economic and social problems. His handling of Egyptian-US and Egyptian-Israeli ties will be important in convincing his countrymen of his presidential qualities. Successful reconciliation with the other Arab governments would boost his standing significantly. The most critical issue, however, will be Mubarak's handling of the economy. There are no quick fixes for Egypt's massive problems. Poorly prepared and executed reforms could spark civil unrest, as in 1977; even well-planned changes will encounter resistance. A patient approach is necessary but so is convincing the Egyptian public that the regime has a viable program for long-term prosperity. US financial assistance can play an important role, but the key decisions must be Egyptian.

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Stability Indicators

There are several indicators to help monitor Egypt's domestic stability. [REDACTED]

- Increased discontent within the military.
- A new government crackdown on the legal opposition and the press.
- Revival of extremist Islamic-sponsored terrorism.
- Renewed Coptic-Muslim sectarian violence.
- An upsurge in student protests.
- Successful efforts to unify the leftist and Islamic wings of the opposition.

Shared Strategic-Military Goals

23. Despite some differences over Arab-Israeli issues, Mubarak believes the United States and Egypt share broader strategic goals. Mubarak is deeply concerned about Soviet ambitions in the Middle East. While he has improved the tone of Soviet-Egyptian relations, he is committed to thwarting Soviet advances in the area. [REDACTED]

sion. In the last six months Egypt has held combined maneuvers with Sudan and Oman to underscore its

support for the regimes of these states. This kind of strategic cooperation was not damaged by the Lebanese crisis. If anything, Cairo would like to increase its role as a "full partner" with the United States in maintaining regional stability but is constrained by its financial weaknesses and lack of access to much of the Arab world.

24. Like Mubarak, the Egyptian military leadership is a strong supporter of the special relationship, and the military in general shares his anti-Soviet views. The military's attitude is grounded in its desire for US equipment and the relatively favorable relationship it has enjoyed with US personnel. Combined exercises such as Bright Star held in 1981 generate a great deal of Egyptian military respect for and understanding of the US armed forces and their capabilities.

25. Nonetheless, the initiation in 1979 of a large US military assistance program for Egypt, whose armed forces were formerly supplied with Soviet arms and utilized Soviet methods, was bound to create day-to-day working problems. The Egyptian armed forces would like to be completely reequipped with modern American weapons, but are frustrated by the limitations of the US Foreign Military Sales (FMS) program. (See table 1.) The senior leadership is procuring additional military assistance from other sources not only to prevent overdependence on a single source, but also to fill perceived shortfalls in the US program. They also believe Egypt has a right to equal status with Israel for military assistance. Military leaders recognize the need for training and infrastructure programs but do not understand the long leadtimes in delivery

Table 1

US Military Sales to Egypt

	Deliveries Begun	Current (Aug 1982)	Projected (Dec 1984)	Anticipated Total Request (Dec 1987)
M-60A3 tanks	1981	311	659	900
M-113A2 armored personnel carriers	1981	511 ^a	858	1,965
TOW launchers	1979	252 ^b	252	600
F-4 aircraft	1979	35	35	35
F-16 aircraft	1981	12	40	80
CH-47 helicopters	1981	15	15	15
C-130 aircraft	1979	20	23	23
I-HAWK batteries	1982	4	12	12

^a Includes 36 acquired by direct commercial contract.

^b Includes 100 acquired by direct commercial contract.

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programs. They believe the United States could do more if it wanted to, and they often cite the accelerated F-4 program as an example.

26. Probably the biggest problem has been instituting the US system for spare parts supplies and maintenance. The Egyptians are still tied to the Soviet scheme of having a one-for-one duplication of spare parts for a given weapon system and have yet to accept the US system of not stocking parts of proven reliability. Also, the Soviets tended to perform routine maintenance rather than train Egyptians. Maintenance problems with F-4 aircraft have been exacerbated by the accelerated delivery schedule Egypt demanded and are largely responsible for Egypt's decision to sell the F-4s. There have been complaints by Egyptian military students in the F-16 program that their training was inadequate and incomplete. Such complaints do not appear to be widespread but

There is a shortage of qualified trainees and US deliveries are straining inadequate Egyptian logistic systems. Basically, the Egyptians would like to have weapons and equipment sooner and worry about training, logistics, and resupply problems later—as opposed to the US FMS package approach of building a step-by-step program designed to utilize the equipment fully and build an effective force.

27. Personnel problems also complicate military ties. Members of the Egyptian military often do not feel comfortable with the goal-oriented US advisers.

American military personnel which many American soldiers do not fully understand.

Economic Linkages and Problems

28. Extensive official and private economic ties between Egypt and the United States (see inset) have played a positive role in supporting domestic stability in recent years. In particular, US economic and military aid has supplemented rising foreign earnings and enabled Egypt simultaneously to pursue rapid economic growth, to rearm its military, and to boost domestic consumption. Despite some unhappiness with aspects of US aid, Egypt's leaders are grateful for the massive aid inflows that have accompanied closer political relations. They believe the US assistance program for Egypt—greater than for any other developing country—provides US political and strategic gains and thus constitutes a fair deal. Reliable substitutes for US aid are not on the horizon. Oil-rich Arab states such as Saudi Arabia and Kuwait—Cairo's previous financial backers—are providing massive aid to Iraq, a more immediate concern to them. Furthermore, potential Arab donors face smaller oil revenues because of the soft world oil market.

Key Economic Linkages

- The United States is the largest donor of economic aid to Egypt, with commitments since 1975 totaling nearly \$7 billion. Slightly more than half has provided balance-of-payments support, with the rest for development projects such as power plants and infrastructure repair.
- Egypt imported 75 percent of its wheat needs in 1981 and 45 percent of the imports came from the United States.
- The United States is Egypt's largest trading partner, providing 20 percent of Egyptian civilian imports and buying 8 percent of Egyptian exports in 1980, the most recent year for which there are data available.
- One US firm—Amoco—discovered, developed, and produces 75 percent of Egyptian oil through its production-sharing subsidiary. The value of this oil during the current Egyptian fiscal year is \$5.7 billion at current world market prices. Egypt uses its share of this oil for domestic consumption and exports.
- One out of seven tourists who visit Egypt is American. Americans are the single largest national group among tourists in Egypt.

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29. Despite the positive aspects of US-Egyptian economic ties, several irritants exist. Foremost is the Egyptians' belief that they have not received the aid flexibility promised by President Mubarak when he visited Washington last February. Egypt's maximum desire is that US economic aid be provided on the same cash transfer basis as US assistance to Israel.

30. Overly prescriptive economic policy advice from US officials has the potential to become a major source of friction. Egyptian leaders appear wary that the United States will go beyond its current policy of encouraging domestic economic reforms and attempt to use aid as a lever on Egyptian economic policies. President Mubarak is clearly aware that economic policies intended to maintain low food and energy prices are counterproductive to economic development and a healthy balance of payments. He also has indicated, however, that he has no intention of making rapid policy shifts that might cause social and political unrest.

31. Although US aid has been essential in helping meet near-term needs and has contributed to development efforts, some longer term impacts are less favorable. Economic assistance has been in the form of either grants or long-term, low-interest loans, but interest payments on US military credits are near market rates and will approach \$500 million a year by the mid-1980s. As Egypt faces a more difficult foreign payments situation in the years ahead, Cairo may seek debt relief for FMS payments. Egypt also is likely to seek a much larger share of new economic aid, or even all, as balance-of-payments support. This would provide the greatest help in maintaining domestic stability in a period of foreign payments problems. It would also come close to the cash transfers provided Israel.

32. Private economic links with the United States create fewer negative responses. US oil firms maintain a low profile in Cairo and their operations are in remote areas of the country. The value of Egyptian oil taken by Amoco for costs and profit under its production-sharing agreement are not revealed by the government. On the other hand, while Egypt has long hosted foreign tourists, high-rise luxury hotels with casinos have been criticized by Islamic fundamentalists because they encourage Egyptians to pursue "foreign" lifestyles.

Outlook

33. Egypt does have alternatives to the US connection, but none can secure all of Cairo's objectives. In extremis, it could return to a close alignment with the USSR as it did in the 1950s and 1960s. Such a dramatic shift is highly unlikely, given the strong anti-Communist views of Mubarak, his key aides, and the leadership of the Egyptian military. Moreover, such a policy would probably be unpopular in Egypt and alienate Israel and Saudi Arabia. Mubarak may continue to normalize ties with Moscow by sending an ambassador, but a fundamental change in relations is not likely.

34. Egypt is moving toward greater nonalignment and closer identification with the Arab states. In Cairo's view, such a policy is not incompatible with close ties to the United States, and Mubarak is seeking to enjoy the benefits of both. The Egyptians clearly hope to gain badly needed financial aid from the oil-rich Arab states. Egypt's ability to reap the full benefits of close ties to the other Arabs, however, remains constrained by its ties to Israel. The soft world oil market has also reduced the Arabs' willingness and ability to aid Egypt. In any case, the Arabs cannot replace the United States as a source of military assistance.

35. The enduring and stable elements of the US-Egyptian "special relationship" are mutual, shared objectives:

- A negotiated, comprehensive Arab-Israeli peace settlement.
- Opposition to Soviet and radical inroads in the Middle East.
- A politically stable and economically prosperous Egypt.

The volatility in the relationship is a product of different perceptions of how to achieve these objectives. The single most important factor in maintaining the special relationship will continue to be US policy toward Israel and the Arab-Israeli conflict. US-Egyptian relations are intimately and irrevocably tied to the US-Egyptian-Israeli triangle in terms of both Egyptian domestic politics and Cairo's regional objectives. Should most Egyptians become convinced that the United States is not willing to press Israel to resolve the Palestinian issue, the special relationship will suffer

new and serious strains. US military and economic linkages and their inherent leverage will not dissuade Mubarak from taking steps to distance Egypt from the United States if he perceives a serious domestic threat from not doing so.

36. The new US initiative announced by President Reagan on 1 September is critical to the future of US-Egyptian ties. Key to Mubarak's policy toward the United States is its ability and willingness to pursue the initiative in the face of Israeli resistance and other regional problems. Cairo is unlikely to participate in peace negotiations until Israel accepts at least some elements of the US proposal as a basis for negotiations and other Arab-Palestinian representatives become involved. Egypt is especially concerned about US willingness to press Israel to alter its West Bank-Gaza policies and freeze the construction of Israeli settlements.

37. Whatever the results of the current initiative, the events of this past summer probably will have some lingering impact on US-Egyptian ties unless there is rapid and dramatic progress in the peace process. Unqualified Egyptian support for major US initiatives in the area can no longer be assumed or taken for granted. In future crises, Cairo probably will be more assertive in proposing its own policy initiatives, such as the French-Egyptian draft Security Council resolution on Palestinian issues that was circulated informally during the Lebanese crisis. Nor are Egyptian-Israeli ties likely to return to business as usual in the next year. Normalization probably will remain stalled even after Israel leaves Lebanon unless there is significant progress in the peace talks. Should PLO leader Arafat visit Cairo, as some reports suggest, Egyptian-Israeli ties will be further strained.

38. Mubarak probably will remain reluctant to engage in new high-visibility combined maneuvers like the Bright Star exercises, at least as long as Israeli troops remain in Lebanon. This does not rule out

continued military cooperation, including training and pre-positioning of equipment in Egypt. Cairo will also adhere to its longstanding policy of minimizing the size of the US presence in Egypt.

39. It is unlikely that Mubarak will be more forthcoming in providing a written commitment for US use of Egyptian facilities [REDACTED]. Such a move would be strongly criticized by the Egyptian opposition and lack support among the elite. Cairo will permit US use of its facilities in a crisis—as during the Iran rescue mission—but will remain unwilling to sign an explicit agreement.

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40. Close cooperation is likely to continue in less visible areas. The most enduring and stable element in the US-Egyptian relationship is shared opposition to Soviet advances in the area. Egypt will continue to provide limited amounts of military aid to pro-US regimes like those in Sudan and Somalia when they are threatened by pro-Soviet states like Libya and Ethiopia. This parallel support for pro-Western regimes may expand to include a larger Egyptian role in assisting Arabian Peninsula states as Egyptian-Arab ties continue to improve.

41. The problems in the Egyptian-US relationship, although serious, are manageable, if given careful attention and a recognition of the limits domestic politics impose on Mubarak. Expectations on both sides must be kept reasonable. The connection is maturing; a rupture is not imminent, inevitable, or likely. Some differences in viewpoint are certain to occur, however, and should be expected. In fact, a somewhat looser identification with US policies could have beneficial effects for the stability of the Mubarak regime and, in so doing, provide a healthier basis on which the two countries can pursue their cooperative and mutually beneficial relationship on issues and in areas that are of key importance to US interests in the Middle East.

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ANNEX A

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BIOGRAPHIC PORTRAITS



Muhammad 'Abd al-Halim
ABU GHAZALA

Deputy Prime Minister; Minister of
Defense and War Production;
Armed Forces Commander in Chief

The hard-charging, blunt-spoken Defense Minister has been promoted twice during the Mubarak presidency: he was named a field marshal in April and elevated to the post of Deputy Prime Minister in August 1982. Abu Ghazala is widely viewed as the probable choice for vice president; he has the military stature to ensure the loyalty of the all-important officer corps. The 52-year-old field marshal is a decorated combat veteran of the 1967 and 1973 Arab-Israeli wars; he is respected within the military for his courage, decisiveness, and military acumen. [REDACTED]

Abu Ghazala's relationship with Mubarak dates from their attendance at the Military Academy, from which they both graduated in 1949; the two men are still close. Like Mubarak, Abu Ghazala received advanced military training in the Soviet Union and, like Mubarak, he has expressed intense dislike for the Soviets. Abu Ghazala is favorably disposed toward the United States and has described with affection the time he spent as defense and armed forces attache in Washington during the years 1976-80. He [REDACTED]

[REDACTED] also believes that Egypt needs to end its isolation from the Arabs and diversify its arms sources.

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Ahmad Fu'ad
MUHI AL-DIN

Prime Minister; Secretary General,
National Democratic Party



Kamal Hasan 'ALI

Deputy Prime Minister; Minister of
Foreign Affairs

A surprise choice as Prime Minister, the self-assured
Muhi al-Din [REDACTED]

[REDACTED] has a long record of public
service—in the ruling political party, in the People's
Assembly, as a three-time governor, and in a succe-
sion of cabinet posts—beginning in the late 1950s. [REDACTED]

[REDACTED] believe he has gained Mubarak's support
through his loyalty and hard work. With no independ-
ent power base, Muhi al-Din [REDACTED]

[REDACTED] knows the personalities and limitations
of the Egyptian political system and, more than
anyone else in the inner circle, is qualified to offer
Mubarak domestic political advice.

Muhi al-Din has been particularly active in attempt-
ing to play the role of arbiter within the cabinet on
important economic issues. Because he has been sing-
led out for sometimes scathing criticism by the
opponents of the regime, Muhi al-Din is the most
likely cabinet candidate for dismissal, should Mubarak
deem that a necessary step to deflect opposition. The
56-year-old Prime Minister, who holds a doctorate in
roentgenology (a branch of radiology) comes from a
politically prominent family.

'Ali serves Mubarak as he did the late Anwar Sadat:
he is the loyal soldier who faithfully carries out the
President's orders. 'Ali came to prominence in Egypt
as a result of his daring in the 1967 and 1973 Arab-
Israeli wars, but it was Mubarak who shepherded his
career into ministerial positions. [REDACTED]

[REDACTED] Mubarak subsequently lobbied for 'Ali's ap-
pointment as Defense Minister (1978-80) and as For-
eign Minister. Mubarak respects 'Ali, but the Foreign
Minister is not Mubarak's closest adviser.

The 61-year-old 'Ali has a reputation of rectitude,
simplicity, and geniality. His name has frequently
surfaced as a possible vice-presidential candidate.

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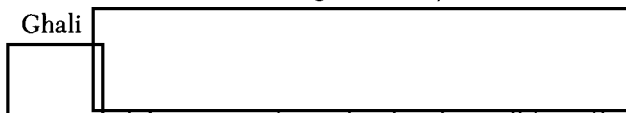


Butrus Butrus GHALI

Minister of State for Foreign Affairs

Brilliant, urbane, and indefatigable, he is a skilled negotiator. Ghali enjoys Foreign Minister 'Ali's respect; he is not known to be close to Mubarak.

Ghali is not a Foreign Ministry insider; he came to his present position in 1977 after a distinguished career in academia. Recognized as an expert in international law, he headed the Center for Political and Strategic Studies in Cairo, and was chairman of the political science department at Cairo University. A Sorbonne-educated Fulbright scholar, the 59-year-old Ghali



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Butrus Ghali is the primary global analyst in the Foreign Ministry. He is the architect of Egypt's African policy and a fervent advocate of Pan-Arabism. His survival in Mubarak's government—despite his intense rivalry with presidential confidant Usama al-Baz—is a recognition of his skills and past performance. Ghali has been an important member of the Egyptian team engaged in the Egyptian-Israeli dialogue since 1977.

Described by a prominent foreign journalist as the most pessimistic man in official Cairo, Ghali has long expressed his concern over Egypt's loss of prestige in the Nonaligned Movement and isolation in the Third World, and his conviction that Egypt must not become the "Cuba of the Western World."

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ANNEX B

ECONOMIC PROSPECTS

1. Egypt so far has weathered recent global economic problems better than most developing countries, but the future is clouded by the government's failure to address fundamental economic problems. The soft oil market and the slowing of other key sources of foreign earnings will make it increasingly difficult to pursue rapid economic growth and expensive government consumer subsidy programs in the coming years. Although the public expects President Mubarak to act decisively to improve economic conditions, there is little public support for the far-reaching economic reforms needed to sustain a healthier economy in the coming years. The greatest threat to economic stability in the coming months is the possibility of a sharp decline in world oil prices. Egypt would have difficulty making up the loss in foreign earnings and would look to the United States for help.

Recent Economic Performance

2. The Egyptian economy in the second half of the 1970s experienced rapid growth and significant changes (see charts). Real growth of 8 to 9 percent was spurred by large inflows of foreign assistance; sharply rising foreign earnings, particularly from oil and worker remittances; and policies more conducive to private sector activity. Egypt also was able to underwrite increasingly expensive consumer subsidies and price controls that shelter low- and middle-income consumers from inflation. Through this intervention in the marketplace and by providing large wage increases, the government helped spread the benefits of growth and prevented inflation from becoming a significant source of domestic instability.

3. Most Egyptians believe, however, that only a privileged few benefited from the improved economic performance. In particular, Sadat's "Open Door" policies are widely believed to have caused enormous maldistribution of wealth, eroding the social equity allegedly achieved under President Nasir. Further-

more, the public is still awaiting the dividend promised by peace with Israel.

4. This year Egypt has withstood the effects of the soft oil market, high interest rates, and the global recession better than most other developing countries. For 1982 we estimate Egypt's current account deficit will be only slightly larger than its \$2 billion deficit in 1981. In 1980 the deficit was \$500 million. We project import growth this year will be less than last because of declines in international commodity prices and restrictions on imports by public sector firms. Egyptian oil export earnings will decline only slightly because export prices have been carefully adjusted to remain competitive and to boost sales. We expect earnings from remittances and tourism to recover from last year's declines because of more favorable exchange rate policies, continuing strong demand for Egyptian workers, and sharply higher tourist bookings for the second half of the year.

5. Nonetheless, with foreign exchange reserves of only \$700 million, which is equivalent to less than one month's imports, the Egyptian Central Bank and government-controlled public sector banks have had to take several measures to deal with a tightening foreign payments situation:

- The Central Bank of Egypt last spring arranged a \$200 million syndicated Eurodollar loan, and two public sector banks have floated loans of \$40 million and \$35 million.
- The Central Bank has leaned on Egyptian importers to seek longer term trade financing and has selectively tightened domestic credit controls to limit demand for nonessential imports.
- The public sector firms have had their access to foreign exchange restricted.
- Public sector banks in July became more active in purchasing foreign exchange from Egyptian workers in Saudi Arabia and other Arab states by paying higher exchange rates.

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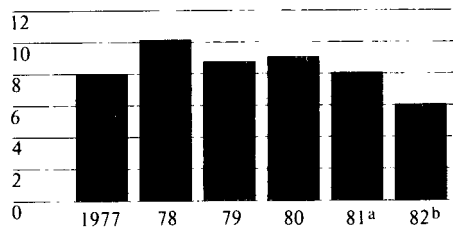
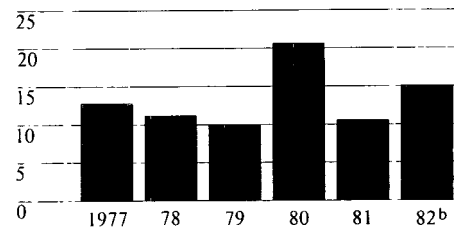
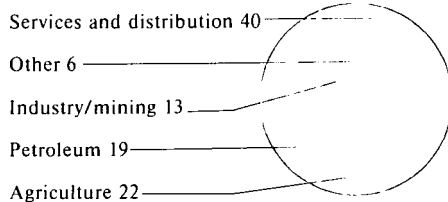
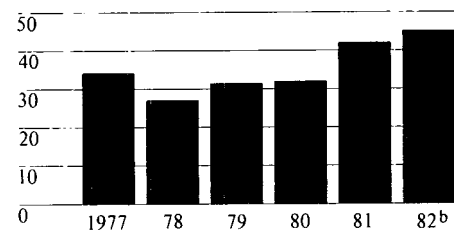
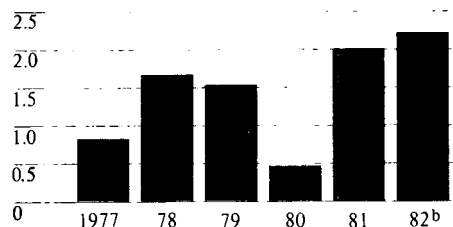
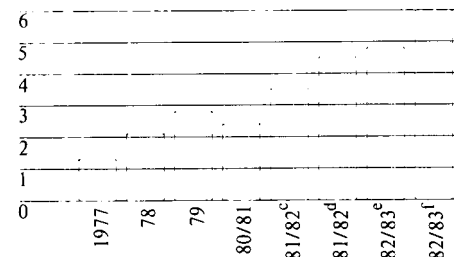
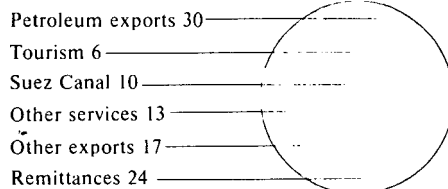
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Egypt: Economic Indicators

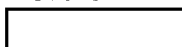
Note change in scales

Real GDP Growth
Percent**Consumer Price Growth**
Percent**Composition of GDP, 1980/81**
Percent**Money Supply Growth**
Percent**Current Account Deficit**
Billion US \$**Government Budget Deficit**
Billion Egyptian Pounds**Composition of Foreign Earnings in 1981**
Percent^a Estimated.^b Projected.^c Initial estimate.^d Actual deficit.^e Initial estimate.

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6. We expect real economic growth in 1982 to be about 6 percent because of the tighter foreign exchange situation. Because of the continued rapid expansion of the money supply stemming from large government budget deficits, the inflation rate has increased to 15 percent annually from 10 percent in 1981. After increasing 42 percent in 1981, the money supply grew at an annual rate of 45 percent in the first four months of 1982. Continuing large government deficits—equivalent to about 20 percent of gross domestic product (GDP)—will fuel further inflation. Although low- and middle-income consumers are sheltered by extensive government price controls and subsidies, consumers with larger disposable incomes who can purchase uncontrolled goods face an annual inflation rate of 30 percent or more.

Gradual Policy Changes

7. Mubarak has attempted to generate popular support for new policy directions that deal with Egypt's fundamental economic policies, A highly touted conference of economic experts and ministers earlier this year did not produce the clear-cut answers Mubarak wanted. There is widespread support for the government to "do something," but no agreement over what should be done and no obvious willingness to bear the burden of economic reforms. The Egyptian people are far more accustomed to promises, even unrealistic ones, than Mubarak's frank talk and work ethic.

8. Mubarak and Prime Minister Muhi al-Din are extremely wary of undertaking necessary policy reforms that risk upsetting domestic stability. Lacking a consensus on bold moves, the government has made only small economic policy changes to deal with more immediate concerns. The minimal policy moves undertaken include:

- Raising consumer electricity prices by 5 to 20 percent on 1 May.
- Hiking controlled interest rates by 1.5 percent on 1 July.
- Increasing public sector wages by 4 Egyptian pounds per worker per month in July, far less than increases by Sadat in recent years.
- Expanding the list of items subject to the consumption tax on 6 July while boosting the tax rates by 5 to 100 percent.

9. With memories of the January 1977 riots over bread price hikes still strong, even these gradual changes have been made with little public fanfare and

so far they have caused grumbling but no unrest.

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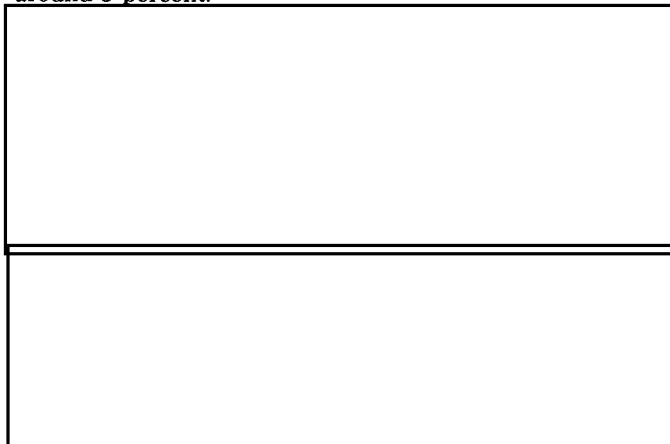
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10. Mubarak's caution is also reflected in recent cabinet switches and the emerging Five-Year Plan, neither of which portends dramatic changes. Discussions with US officials indicate that the new economic ministers do not intend to propose major reforms, but instead agree with Mubarak's policy of increasing production. This emphasis is embodied in the Five-Year Plan. While not yet finalized, Mubarak's statements about the new plan indicate no significant shifts in priorities between the public and private sectors. The public sector will receive new investment funds, but its scope will not be broadened. The private sector will be encouraged to increase "productive" investments through new efforts to make the "Open Door" policies work better.

The Coming Year

11. Egypt's foreign payments in 1983 will continue to worsen since no large new sources of foreign earnings are in sight. We project the current account deficit will increase to \$2.5 billion, assuming (a) oil prices remain at present levels, (b) the government encourages remittances and tourist earnings through competitive exchange rate policies, and (c) the government keeps the lid on public sector imports.¹ It is unlikely that inflation will fall from the present level of 15 percent, and real economic growth is likely to be around 5 percent.

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Mubarak could also crack down on luxury imports and more vigorously pursue anticorruption programs. While these programs might help win political support, they would not improve the economy's performance.

13. Should oil prices decline sharply in the coming year, as some observers believe they could, Egypt will be under increased pressure to secure additional foreign financial inflows and to reconsider politically sensitive reforms. We estimate that for each \$1-per-barrel decline in the price of oil, Egypt loses \$200 million in foreign earnings. For example, if oil prices fall to \$24 per barrel, Egypt would face a 1983 current account deficit on the order of \$4 billion, as compared with a projected deficit of \$2.5 billion if oil prices remain stable. (See table 2.) Since official foreign exchange reserves amount to less than one month's exports, a steep oil price decline would leave Egypt scrambling for alternative financing.

14. The willingness of other Arab states to provide aid, however, would be limited by political considerations as well as their own oil earnings shortfalls. Commercial funding also would be difficult to obtain in a period of financial uncertainty caused by steep oil

price declines. The United States, therefore, almost certainly would be asked to provide greater balance-of-payments support. Egypt could seek to receive a larger share or even all of its economic aid this fiscal year as balance-of-payments support. Cairo would count on the United States for sympathetic understanding of the domestic political imperatives for such assistance. Egypt ultimately could be forced to turn to the International Monetary Fund and would seek US help in limiting IMF conditions.

15. Foreign exchange difficulties caused by a sharp drop in oil prices could be used by the government to justify unpopular reforms. This argument, however, would not be well received in Egypt. Mubarak's efforts to educate Egyptians about the hard economic facts of life apparently have done little to convince the public of the magnitude of these problems, nor have they stopped the erosion of his credibility. Should the government be forced to impose austerity measures as part of an agreement with the IMF, the Egyptian public and opposition would blame the country's problems on inept leadership or perhaps even the close relationship with the United States.

Beyond the Next Year

16. Although economic growth has continued in 1982 and the government has so far avoided a major

Table 2

Egypt: Current Account Balance ^a (billion US dollars)

	1980	1981	1982 ^b	1983 ^b
Trade balance	-3.7	-4.4	-5.5	-6.0
Exports	3.9	4.4	4.3	4.7
Oil	2.5	2.8	2.6	2.9
Nonoil	1.3	1.6	1.7	1.8
Imports	7.6	8.8	9.8	10.7
Net services	3.2	2.4	3.2	3.4
Receipts	5.3	4.9	6.0	6.5
Remittances	2.7	2.2	2.8	3.0
Suez Canal	0.7	0.9	1.0	1.1
Tourism	0.8	0.6	0.8	0.9
Other	1.2	1.3	1.4	1.5
Payments	2.2	2.5	2.8	3.1
Unrequited transfers	0.1	0.1	0.1	0.1
Current account balance	-0.5	-2.0	-2.2	-2.5

^a Figures may not add because of rounding.

^b Projection assuming oil prices in 1983 remain at current levels through the end of the year.

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foreign payments crisis, Egyptian officials have not addressed the longstanding economic problems that dim future prospects. We believe the government will continue to avoid tackling the major issues until forced by foreign payments problems. We also believe that a failure to deal with these issues will continue to hobble the performance of the economy and will make the ultimate imposition of reforms even more difficult. Because of the likely unpopularity of reforms, however, we believe that when the government does finally take tougher action, it may well have to impose stricter domestic security measures to maintain domestic stability.

17. **Rapid Population Growth.** Population growth of close to 3 percent a year is adding more than a million Egyptians each year to the narrow confines of the Nile valley and delta. Population densities in urban and rural areas are some of the highest in the world. Egypt's leaders are well aware that population pressures underlie many of the country's economic woes, but they have been unwilling to challenge Egyptian and Islamic traditions that encourage large families.

18. **Large Budget Deficits.** Budget deficits equal to 20 percent of GDP and financed largely through money creation are fueling inflationary pressures and stimulating import demand. Dealing with the budget deficit, however, would require tough political choices on price controls, subsidies, and taxes that the leadership will remain unwilling to face.

19. **Subsidized Food Prices.** Low subsidized food prices—bread at 5 cents a pound and sugar at 6 cents a pound—have spared Egyptians the malnutrition that affects many Third World peoples but at a high cost. Subsidies cost the government more than 2 billion pounds a year. Agricultural productivity also has been affected adversely by controls on farm prices, and

imports have increased because of the demand for food. In 1981, Egypt imported nearly half of its nine basic food items. Although President Mubarak has strongly emphasized the costs of food subsidies in recent speeches, he has promised not to change the system because of political opposition.

20. **Low Energy Prices.** Controlled domestic energy prices have led to rapid consumption increases, lower government oil revenues, and energy-inefficient investments. Domestic petroleum prices average 20 percent of world market prices. This results in a major loss of domestic revenues for the government and reduces supplies available for export. The government has put off significant energy price adjustments because of the rippling inflationary effect they would have throughout the economy.

21. **Public-Sector Inefficiency.** With few exceptions, public-sector industries are not efficient. They are forced to carry excess workers and charge low prices, and they are not required to earn a profit. Public-sector workers and managers, however, constitute a powerful political lobby against reforms and they are supported by the socialist tendencies among the political elite.

22. **Inadequate Public Services and Housing.** The 10-million-plus residents of the greater Cairo area must cope with overburdened public services and inadequate housing supplies. While urban Egyptians obviously choose to live in this crowded urban environment rather than in the countryside, there is growing frustration over the quality of urban life. It is a Herculean task for the government just to prevent existing problems from worsening, let alone to make significant improvements. Mubarak, however, seems intent on improving conditions in Cairo and has asked for US help.

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